

Message Text

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ACTION TRSE-00

INFO OCT-01 EA-10 ISO-00 NEA-10 IO-13 L-03 H-01 PA-01
SP-02 ICA-11 AID-05 EB-08 NSC-05 SS-15 STR-07
OMB-01 CEA-01 CIAE-00 COME-00 FRB-03 INR-10
NSAE-00 XMB-02 OPIC-03 LAB-04 SIL-01 /117 W
-----102393 120839Z /10
P 120806Z JUL 78
FM AMEMBASSY MANILA
TO SECSTATE WASHDC PRIORITY 8322

LIMITED OFFICIAL USE SECTION 01 OF 02 MANILA 11687

USADB

PASS TREASURYDEP FOR SHERK

EO 11652:NA
TAGS: EAID, EFIN, ADB
SUBJECT: SELECTION OF CURRENCIES FOR LOAN DISBURSEMENTS
AND REPAYMENTS AMONG BORROWERS FROM ADB'S
ORDINARY FUNDS

1. ADB MANAGEMENT HAS ISSUED WORKING PAPER 4-78 WHICH
CONCERNS ITSELF WITH CRITERIA USED BY BANK IN SELECTION
OF CURRENCIES FOR DISBURSEMENTS UNDER LOANS FROM BANK'S
ORDINARY CAPITAL (OC) RESOURCES. PAPER WAS POUCHED
STATE/AID AND TREASURY ON JULY 6 AND WILL BE CONSIDERED
BY BOARD OF DIRECTORS ON JULY 25.

2. PROVISIONS OF THE ADB CHARTER ARE DESIGNED TO ENSURE
THAT THE BANK'S OPERATIONS ARE CONDUCTED WITH A MINIMUM
EXPOSURE TO EXCHANGE RISK. IN THE CASE OF LOAN DIS-
BURSEMENTS, THE BANK IN ACCORDANCE WITH THE PURPOSE OF
ARTICLE 24.4 OF THE CHARTER REQUIRES THE BORROWERS TO
REPAY A LOAN IN THE SAME CURRENCY USED BY THE BANK IN
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PURCHASING THE CURRENCY REQUESTED BY THE BORROWER.

3. THROUGH END OF DECEMBER 1977 TOTAL OUTSTANDING LOANS
HELD BY BORROWERS FROM OC RESOURCES AMOUNTED TO DOLS
1,088.3 MILLION. BORROWERS' UNREALIZED TRANSLATION (OR
BOOK) LOSSES ON THESE AMOUNTS WERE EQUIVALENT TO 10.5
PERCENT OF OUTSTANDING LOANS. ON OC LOAN REPAYMENTS OF

DOLS 131.7 MILLION AS OF THE SAME DATE, BORROWERS HAVE ACTUALLY REALIZED A CONVERSION LOSS OF ABOUT 1.7 PERCENT.

4. OF ALL OC LOAN DISBURSEMENTS, 81.6 PERCENT HAVE BEEN RECEIVED BY FIVE COUNTRIES (KOREA, MALAYSIA, PAKISTAN, PHILIPPINES THAILAND). THIS GROUP'S UNREALIZED TRANSLATION LOSSES HAVE ONLY DIFFERED IN THE RELATIVELY NARROW RANGE BETWEEN 9.5 PERCENT TO 11.6 PERCENT, WHICH INDICATES A FAIRLY EVEN DISTRIBUTION OF EXCHANGE EXPOSURE BETWEEN THESE COUNTRIES.

5. NINE OTHER COUNTRIES HAVE RECEIVED THE REMAINING 18.4 PERCENT OF OC DISBURSEMENTS IN AMOUNTS AT MORE IRREGULAR INTERVALS AND SHOW A MUCH BROADER RANGE OF TRANSLATION LOSSES FROM 4.6 PERCENT UP TO 60 PERCENT IN ONE COUNTRY (BURMA). THE FIGURES INDICATE THESE COUNTRIES HAVE RECEIVED A SOMEWHAT UNEQUAL DISTRIBUTION OF CURRENCIES.

6. REGARDING SUB-BORROWERS OF DEVELOPMENT FINANCE INSTITUTIONS (DFI'S) ONLY, OF A TOTAL OF 885 SUB-LOANS OUTSTANDING AT END OF 1977, 46 PERCENT CARRY LOANS OF WHICH DISBURSEMENTS HAVE BEEN MADE ENTIRELY IN ONE APPRECIATION-PRONE CURRENCY AND ANOTHER 15 PERCENT CARRY LOANS OF WHICH OVER HALF OF DISBURSEMENTS HAVE BEEN MADE IN ONE SUCH CURRENCY. THESE SUB-BORROWERS ARE THEREFORE LIMITED OFFICIAL USE

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SPECIFICALLY VULNERABLE TO ADVERSE EXCHANGE RATE MOVEMENTS DUE TO A LACK OF MIXTURE OF CURRENCIES AND VERY HIGH EXPOSURE TO ONE OR A FEW APPRECIATION-PRONE CURRENCIES.

7. UNDER PRESENT PROCEDURES OF CURRENCY ALLOCATION AMONG BORROWERS AND THE EXISTING FLOATING EXCHANGE RATE SYSTEM, THERE IS NOTHING THE BANK CAN DO ON A WIDE AND PRACTICAL SCALE TO REDUCE THE EXCHANGE RISK EXPOSURE OF BORROWERS AS A GROUP. WITH REDUCED DEPENDENCE ON PAID-IN CAPITAL, THE BANK'S PRACTICE OF DISBURSING LOW-YIELDING CURRENCIES AND RETAINING HIGH-YIELDING CURRENCIES IN ITS INVESTMENT PORTFOLIO IS A RATIONAL ONE WHICH IS ALSO FOLLOWED BY THE WORLD BANK. IN PRACTICE, THE BANK'S FREEDOM TO CHOOSE CURRENCY FOR DISBURSEMENTS IS SIGNIFICANTLY LIMITED TO FACT THAT (A) IT HAS TO DEPEND SUBSTANTIALLY ON BORROWED FUNDS WHICH NORMALLY HAVE TO BE RAISED IN CAPITAL-EXPORTING COUNTRIES WITH APPRECIATION-PRONE CURRENCIES; AND (B) IT FREQUENTLY HAS TO ACCEPT UNDERSTANDING WITH THESE CAPITAL-EXPORTING COUNTRIES THAT IT WILL USE BORROWING PROCEEDS IMMEDIATELY FOR DISBURSEMENTS.

8. WORKING PAPER CONCLUDES THAT BANK SHOULD, IN GENERAL, CONTINUE ITS ASSET MANAGEMENT PRACTICES, SINCE MORE THAN 80 PERCENT OF OC LOAN DISBURSEMENTS ARE CONCENTRATED ON FIVE BORROWING COUNTRIES WHICH HAVE SUFFERED A FAIRLY EQUAL INCIDENCE OF UNREALIZED TRANSLATION EXCHANGE LOSSES. HOWEVER, RECOGNIZING THAT PROBLEMS OF UNEVEN EXCHANGE EXPOSURE HAVE ARISEN, AND MAY CONTINUE TO ARISE, UNDER SUCH PRACTICES BOTH FOR BANK'S SMALLER BORROWERS AND FOR SUB-BORROWERS UNDER ITS LOANS TO DFI'S, BANK WILL FURTHER EXAMINE THESE PROBLEMS. WITH REGARD TO LOANS TO SMALLER BORROWERS, IT MAY BE POSSIBLE FOR BANK TO CONSIDER INTRODUCING SOME FORM OF PERIODIC MONITORING

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ACTION TRSE-00

INFO OCT-01 EA-10 ISO-00 NEA-10 IO-13 L-03 H-01 PA-01

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FM AMEMBASSY MANILA

TO SECSTATE WASHDC PRIORITY 8323

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PASS TREASURYDEP FOR SHERK

SYSTEM WITH A VIEW TO SOME CORRECTIVE ACTION. REGARDING LOANS TO DFI SUB-BORROWERS WHERE AMOUNTS OF DISBURSEMENTS ARE SUBSTANTIAL, IT WILL BE IMPORTANT FOR THE BANK TO PROCEED IN CLOSE CONSULTATION WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS AND IN PARTICULAR WITH THE WORLD BANK WHICH IS KNOWN TO HAVE THE PROBLEM ALSO UNDER CLOSE EXAMINATION.

9. USADB COMMENT: BANK APPROACH TO THIS PROBLEM SEEMS TO US TO BE A RATIONAL ONE DESERVING OF OUR SUPPORT. WE WOULD, HOWEVER, APPRECIATE ANY COMMENTS THAT MAY BE PASSED ON TO BOARD AND MANAGEMENT CONCERNING WORLD BANK DELIBERATIONS ON THIS SAME ISSUE. EDMOND

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